

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 01-0262  
Sales and Use Tax  
For the Years 1999-2000**

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**ISSUE**

**I.     Sales and Use Tax- Manufacturing Exemption**

**Authority:** IC 6-8.1-5-1 (b), IC 6-2.5-3-2, IC 6-2.5-5-3, 45 IAC 2.2-5-10, 45 IAC 2.2-5-8(g), *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948).

The taxpayer protests the imposition of the use tax on a detro shaker and lamp bulbs for the microfiche reader.

**II.    Sales and Use Tax-Consumables**

**Authority:** IC 6-2.5-3-2, IC 6-2.5-2-1, Information Bulletin #28 for Sales and Use Tax, issued June, 1992.

The taxpayer protests the imposition of the use tax on consumables.

**III.   Tax Administration-Penalty**

**Authority:** IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the penalty.

**IV.    Tax Administration-Interest**

**Authority:** IC 6-8.1-10-1.

The taxpayer protests the imposition of interest.

## **STATEMENT OF FACTS**

The taxpayer is a Sub-Chapter S corporation that operates a body shop which repairs and refinishes cars, converts vans, and manufactures a part used by another local company. After an audit, the Indiana Department of Revenue, hereinafter referred to as the “department,” assessed additional sales and use tax, interest, and penalty. The taxpayer protested this assessment and a hearing was held.

### **I.     Sales and Use Tax- Manufacturing Exemption**

#### **DISCUSSION**

The use tax is imposed on an Indiana use of tangible personal property purchased in a retail transaction. IC 6-2.5-3-2. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. IC 6-2.5-5-3 provides for the exemption of “manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . processing, refining , or finishing of other tangible personal property.” 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production. Property has such an immediate effect if the property “is an essential and integral part of an integrated process which produces tangible personal property.” 45 IAC 2.2-5-8(g).

All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948). All assessments made by the department are presumed to be correct. Taxpayers bear the burden of proving that an assessment is incorrect. IC 6-8.1-5-1 (b).

The department assessed use tax on a detro shaker and light bulbs for a microfiche reader. The taxpayer protested these assessments. The taxpayer contends that the detro shaker and light bulbs qualify for the manufacturing exemption. Both of these items are used in the process of producing custom converted vans. The light bulbs are used in reading paint formulas with the microfiche reader. The detro shaker shakes the paint prior to the spraying of the paint onto the van. The taxpayer argues that since it must read the formula and shake the paint to convert vans, the detro shaker and light bulbs are essential and integral to the van conversion process. The department disagrees. The preparation of a material for application takes place prior to the beginning of the industrial process. Therefore, the department properly assessed use tax on the use of the light bulbs and detro shaker.

#### **FINDING**

The taxpayer’s protest is denied.

### **II.     Sales and Use Tax-Consumables**

## **DISCUSSION**

The taxpayer uses many consumable items such as masking tape and disposable rags in the process of van conversion. The taxpayer protests the assessment of use tax on these consumable shop supplies. The taxpayer contends that they work with third party insurance companies that remit the payment for insured customers. According to the taxpayer, the industry practice is to pay a fixed dollar amount per repair hour for all materials used. The taxpayer lists "paint materials" on its estimates as allegedly required by the third party insurers. The taxpayer contends that the term "paint materials" includes the paint and the consumable shop supplies. The taxpayer charges sales tax on the amount of the "paint materials." The taxpayer contends that it should not have to pay use tax on the consumable shop supplies since sales tax was collected and remitted on the "paint materials" which includes the consumables.

The use tax is paid by the user or consumer of the tangible personal property. IC 6-2.5-3-2. Indiana also imposes a sales tax "on retail transactions made in Indiana. The purchaser of the tangible personal property is liable for payment of the sales tax. Merchants collect the sales tax as agents of the state and remit the tax to the Indiana Department of revenue. IC 6-2.5-2-1.

Information Bulletin #28 for Sales and Use Tax, issued June, 1992, clarifies the sales and use tax laws for motor vehicle sales and repairs. The clarification of the taxability of shop supplies is as follows:

Consumable supplies, such as masking paper and tape, oil dri, sandpaper, buffing pads, rags and cleaning supplies, used to repair and service motor vehicles are subject to use tax if purchased exempt from sales tax. The purchaser becomes the final user of such items because its customer does not become the owner of such consumable supplies. Although the dealer may charge the customer for such items, the items are not being sold to the customer in a retail transaction. Use tax should be self assessed and remitted by the purchaser directly the Department if such consumable supplies were purchased exempt from sales tax.

In the taxpayer's situation, it is the final user of supplies such as those described in the Information Bulletin concerning the repair of the automotive vehicles. Taxpayer does not pay sales tax when it purchases the shop supplies. The shop supplies are not sold to the customer in a retail transaction. Therefore, the taxpayer owes use tax on the consumable shop supplies.

The taxpayer's contention that sales taxes were incorrectly collected and remitted to Indiana on those shop supplies does not change the taxpayer's use tax liability.

### **FINDING**

The taxpayer's protest is denied.

### **III. Tax Administration-Penalty**

#### **DISCUSSION**

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to reach and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Pursuant to this standard, taxpayers have the duty to learn about and follow the tax laws of the state. Although the Indiana law clearly provides that taxpayers owe use tax on tangible personal property consumed in the provision of a service, the taxpayer had no system for self-assessment of use tax and ignored its obligation to remit use tax to the state. Also, the taxpayer failed to self-assess and remit the use tax on clearly taxable items such as coveralls used to keep employees clean and maintenance items. These breaches of the taxpayer's duty constitute negligence.

### **FINDING**

The taxpayer's protest is denied.

### **IV. Tax Administration-Interest**

#### **DISCUSSION**

The taxpayer protests the imposition of interest. IC 6-8.1-10-1 provides that the department must assess interest if a taxpayer "incurs a deficiency upon a determination by the department." The law continues to state that "the department may not waive the interest imposed under this section." The department, therefore, has no discretionary authority to waive the interest.

### **FINDING**

The taxpayer's protest is denied.